Direct and Opportunity Cost

We know that all decisions in the economic world are based on trying to fill as many wants as we can with limited resources.  Each and every one of you know that you want things, but have to make decisions on what you can afford, and how you can acquire it given your limited resources.  Anytime that a decision is to be made, a smart decision maker will look at the costs associated with it.  There are three different types of costs that we use to make our decisions:

1. Direct Costs – Direct costs are the out of pocket expenses that are required to do something.
2. Opportunity Cost – Opportunity costs are defined as the value of the next best possible alternative that is sacrificed.
3. Total Cost – The total of both direct and opportunity costs.

**Opportunity Costs video**

When decision making you need to look at each opportunity in terms of benefits and costs for example let’s say that you are deciding what to do with your life after your graduate.  You have two options

1. Go to Post – Secondary School
2. Work

The direct costs of going to University will include tuition, books, supplies, rent and living expenses.   The opportunity cost of attending University could be the salary or wage you could have had while working at home.

Every time that you spend money you will incur not only a direct cost but an opportunity cost as well.  Let’s say that you have saved $7000.00 and you decide that you are going to spend that money on the car.  The direct cost of the car would be the $7000, but what would be the opportunity cost?  You could put that money into savings accounts and make interest on the original investment.  Let’s assume you could have earned 5% on the 7000.00 per year.  This means that you could have earned $350.00 per year on that money; however you decided to give it up.  The total cost of your decision would be 7350.00 (opportunity cost + direct cost).  Every decision that you make will always incur and opportunity cost because you have to sacrifice something in order to do it.

**Survival Activity**